

EMPLOYEES' RETIREMENT SYSTEM OF THE COUNTY OF MILWAUKEE

MINUTES OF THE OCTOBER 15, 2008 PENSION BOARD MEETING

1. Call to Order

Chairman Dr. Dean Roepke called the meeting to order at 8:30 a.m. in the Green Room of the Marcus Center, 127 East State Street, Milwaukee, Wisconsin 53202.

2. Roll Call

Members Present:

Linda Bedford (Vice Chair)
Donald Cohen
Roy Felber
Mickey Maier
Jeffrey Mawicke
Marilyn Mayr
John Parish
Dr. Dean Roepke (Chairman)

Members Excused:

Dr. Sarah Peck

Others Present:

David Arena, Director of Employee Benefits, Department of Administrative Services
Mark Grady, Principal Assistant Corporation Counsel
Gordon Mueller, Fiscal Officer
Dale Yerkes, Assistant to the Fiscal Officer
Annette Olson, Human Resources, ERS
Sushil Pillai, V3 Project Manager
Bess Frank, Ad Hoc Oversight Committee
Steven Huff, Reinhart Boerner Van Deuren s.c.
Leigh Riley, Foley & Lardner LLP
Chris Trebatoski, Weiss Berzowski Brady LLP
Terry Dennison, Mercer Investment Consulting
Kristin Finney-Cooke, Mercer Investment Consulting
Patrick Siverstri, Mercer Investment Consulting
Tom Rosalanko, GMO
Carolyn Van Putten, GMO
Wayne Morgan, Virchow, Krause & Co. LLP
Darlene Middleman, Virchow, Krause & Co. LLP
Ken Loeffel, Retiree
Louis Metz, Retiree
Nancy Beck-Metz, Retiree

Esther Hussey, Retiree
Gloria Yelezyn, Retiree
Steve Schultze, Reporter, *Milwaukee Journal Sentinel*

3. Chairman's Report

The Chairman discussed the status of the investment consulting request for proposal. He indicated that the Pension Board received 15 responses from some of the leading firms in the investment consulting field. He stated that one response was disqualified because that firm did not adhere to the terms of the RFP. He noted that the evaluation panel is meeting the following week to continue its review of the proposals.

The Chairman stated that Mr. Parish is retiring from Milwaukee County at the end of October and that today's meeting is Mr. Parish's last meeting as a member of the Board. He indicated that a discussion regarding replacing Mr. Parish should be added to next month's meeting agenda.

The Chairman indicated that in response to media inquiries, he prepared a press release for public distribution detailing the impact the decline in the financial markets has had on ERS's investments.

4. Minutes of the September 17, 2008 Pension Board Meeting

The Pension Board reviewed the minutes of the September 17, 2008 Pension Board meeting.

The Pension Board voted by roll call vote, 5-0-1, with Ms. Mayr abstaining due to her absence from the September 17 Pension Board meeting, to approve the minutes of the September 17, 2008 Pension Board meeting. Motion by Mr. Maier, seconded by Mr. Parish.

5. Reports of Employee Benefits Director

(a) Retirements Granted

Mr. Arena presented the Retirements Granted Report for September 2008. He reported that 15 retirements were granted in September, noting that 8 retirees elected backDROPs in amounts totaling \$562,946.

(b) ERS Monthly Activities Report and Organizational Chart

Mr. Arena reviewed the 2008 ERS Monthly Activities Report for September 2008. The report indicated that the total amount of benefit payments made through September 2008 is approximately \$50 million lower than the amount of benefits paid through the same period in 2007.

6. Investments

(a) Mercer Report

Mr. Dennison noted that he is presenting from a pre-release version of a Mercer Investment Consulting market letter that Mercer prepared over the weekend. He described some system-wide concerns in the markets, such as the credit freeze. He pointed out that companies depend on short-term borrowing and liquidity to conduct business. He commented that some sectors have higher risk than others, particularly the automobile industry.

Mr. Dennison noted that due to the decline in share prices, some investors are taking advantage of an opportunity to buy at lower prices. He stated that the global equity markets are in a near free fall. He discussed the effects the Lehman Brothers bankruptcy had on the market. He noted that the liquidity problems in the U.S. are improving, but there are concerns in the foreign markets. He discussed how banks can leverage themselves between 10 to 15 times, but are very reluctant to extend credit.

Mr. Dennison asked why affordable houses are not being purchased when interest rates are low. He stated the reason these homes are not selling is because the credit standards have been raised too high, making it hard for buyers to obtain credit to purchase their homes. He indicated that many people used their home equity to purchase consumer goods. He discussed the housing market, noting that house prices are more accurately reflecting their fair market values. He pointed out that there are some positive economic signs, such as decreasing energy prices, which will result in savings of between \$1,500 to \$2,000 of after-tax dollars per household.

Mr. Dennison reported that U.S. manufacturing exports benefit from the weak value of the dollar. He indicated that the U.S. trade deficit is currently 5%, and almost 0% when oil is excluded, which is a decrease from the 6% trade deficit in 2005.

Mr. Dennison discussed the effect of the settling of the Lehman Brothers credit default swaps in the market. He indicated that net effect of settling these credit default swaps was much smaller than anticipated. He noted that spreads are still very high, which reflects the credit risk. He pointed out that some high-yield bonds are returning 18%, which is unsustainable. He stated that the current market makes Treasuries unattractive. He commented that TIPS may be attractive if inflation increases and continues. He indicated that equities are attractive because they are either properly valued or slightly undervalued. He noted that the low stock prices might increase the flow of capital into the U.S.

Mr. Dennison stated that there are few options available to prevent investment losses and noted that they are expensive. He indicated that loss prevention techniques, such as selling puts and buying hedging strategies are more expensive in the current economic times. He pointed out that ERS has the time to ride through these investment downturns because ERS will continue forever. He noted that selling at the bottom is the worst thing an investor could do because the investments have a good chance of regaining their value.

In response to a question from Mr. Maier regarding asset rebalancing, Mr. Dennison stated that ERS is within its asset allocation guidelines, but he noted that now would be an attractive time to rebalance depending upon the facts and circumstances, including transaction costs. He indicated that Mr. Silvestri will discuss rebalancing in more depth later in the presentation.

Mr. Dennison stated that ERS is underweight in equities and slightly overweight in fixed income. He noted that ERS must maintain liquidity for benefit payments. He explained that in order to liquidate bonds, a decision must be made by the fixed income managers to determine if it is economically feasible to sell bonds to make benefit payments or to rebalance and buy equities. He reported that the only liquid fixed income investment is Treasuries because the spreads are high for other fixed income investments, making them relatively illiquid. Ms. Finney-Cooke pointed out that ERS is currently at the higher end of its investment guidelines for its fixed income allocation. Mr. Silvestri pointed out that ERS could be outside of its asset allocation guidelines in October because it has been a very negative month.

Ms. Finney-Cooke presented Mercer's Flash Report for September 2008. She stated that ERS had a market value of just over \$1.33 billion at the end of September and that ERS's market value declined by 6.7% during September, which outperformed the reference index by 100 basis points. She noted that ERS is down 12.7% for the year to date, which is 100 basis points ahead of ERS's reference index.

Ms. Finney-Cooke reviewed the performance of each asset class, noting that value outpaced growth in the large and small cap spaces. She stated that most of ERS's investment managers outperformed their benchmarks, except for Westfield Capital Management, AQR, Reinhart Partners and Loomis Sayles. In response to the Chairman's question, Ms. Finney-Cooke stated that AQR's hedge fund focus does not hurt ERS's investment return.

Ms. Riley pointed out that Loomis Sayles' core fixed income strategy is significantly behind its benchmark. Mr. Finney-Cooke reported that the Investment Committee reviewed Loomis Sayles' performance at its last meeting. She pointed out that eight weeks ago, Loomis was in line with its benchmark over longer periods. She stated that Mercer will continue to monitor its performance.

She indicated that Loomis is in a bad cycle, but Mercer continues to have confidence in Loomis. Mr. Silvestri commented that Loomis is a manager with a high tracking error, which means that it will under and outperform its benchmark by wide margins. Ms. Finney-Cooke noted that the global real estate manager outperformed its benchmark.

As background, the Chairman indicated that at its last meeting the Pension Board requested that Mercer give a special presentation on the current economic crisis and recommend specific courses of action that the Pension Board may want to consider implementing going forward. Mr. Silvestri stated that the liquidity shortage in the market caused problems in all securities lending programs. He noted that Bank of New York Mellon runs ERS's securities lending program. He reported that ERS's losses have come from securities owned and securities in commingled funds. He recommended that the Pension Board take an in-depth look at the securities lending program Bank of New York Mellon.

In response to a question from Ms. Mayr, Mr. Silvestri stated that the Sigma investment has been written off because it is an impaired asset that in Mercer's opinion will not be recovered. In response to a follow-up question from Ms. Mayr, Mr. Silvestri indicated that Mercer agrees with the figures contained in the Chairman's press release.

Mr. Silvestri stated that the fixed income markets are frozen. He indicated that ERS can withdraw funds from Mellon to provide liquidity, but Mellon may need to trade portions of its fund to obtain cash, for example, it would avoid selling the long-term portion of the fund. He pointed out that using this approach may result in tracking error from the benchmark in future months. He suggested that ERS draw down \$10 million from Mellon for October benefit payments and pick and choose the liquid portions of ERS' portfolio with Mellon.

Ms. Finney-Cooke suggested that Mercer evaluate the securities lending program at Bank of New York Mellon. She stated that the evaluation will involve an in-depth review of its securities lending program to ensure that there are no additional surprises. The evaluation will document that ERS's appropriate and best interests are being met. She indicated that the Sentinel Group, a subgroup of Mercer, would perform the in-depth review. Mr. Dennison stated that the Sentinel Group would take a look at the processes at Bank of New York Mellon. He commented that other plans have much worse problems with their securities lending programs than ERS.

In response to a question from Mr. Maier, Mr. Dennison stated that the involvement of the Sentinel Group is included in the current retainer. The Chairman requested that Mercer coordinate with the Board's fiduciary counsel on the findings of the review. In response to a question from Mr. Maier,

Mr. Dennison stated that the final work product of the review is unknown and will depend on what is found during the review.

Mr. Silvestri recommended that the \$10 million needed per month for benefit payments for the rest of the year come from Mellon.

The Pension Board unanimously approved the recommendation made by Mercer to engage the Sentinel Group to perform an in-depth review of the securities lending program at Bank of New York Mellon. Motion by Mr. Cohen, seconded by Mr. Maier.

(b) Investment Manager Report – GMO

Mr. Rosalanko and Ms. Van Putten distributed a report on GMO's management of ERS's international equity strategy and presented it to the Pension Board on behalf of GMO. Ms. Van Putten stated that GMO is a privately held partnership with 43 partners. She indicated that the firm only focuses on investment management and has very low turnover among its investment professionals. She noted that the GMO takes a team approach to investing.

Mr. Rosalanko reported that GMO has outperformed its benchmark for the year, but noted that he hates to see the negative returns due to the bear market. He reviewed GMO's investment philosophy and approach, which focuses on selecting high-quality, undervalued companies. He indicated that GMO's stock selection is based 80% on value and 20% based on momentum. He pointed out that there is extreme volatility in the market place, and that there is no clear winning trend between quality adjusted value, intrinsic value and momentum. He stated that the ERS portfolio holds approximately 300 stocks.

He discussed how the value portion of the stock selection process is split into quality adjusted value, which focuses on how the company has performed, and intrinsic value, which focuses on how the company will perform in the future. He indicated that momentum focuses on how the stock price has performed over the last year. In response to a question from the Chairman, Mr. Rosalanko agreed that momentum is riding the wave of the market.

Mr. Rosalanko summarized GMO's performance for the year to date. He stated that the ERS portfolio managed by GMO is down 27%, while the comparable market is down 29.3%. He reported that GMO has outperformed its benchmark over all of the timeframes, including 1, 3 and 5 year and since inception periods.

Mr. Rosalanko reviewed the top and bottom five stock performers for the year and explained the reasons behind their performance. He reviewed the performance attribution by country and noted that country allocation mattered little to the

portfolio's performance, while stock selection affected the portfolio's performance by -0.8%. He pointed out that sector allocation, especially overweighting in health care and underweighting in financials, helped contribute 1.9% to the portfolio's performance.

The Chairman stated that Europeans find comfort in big strong banks and asked what GMO's view is of Asian banks. Mr. Rosalanko commented that GMO views Asia as somewhat cheap, but not overwhelmingly cheap. Mr. Rosalanko stated that GMO is a quantitative manager and does not have banking analysts. He indicated that he did not think bad investments would crush the financial institutions as quickly as they did. He opined that the actions taken by the U.S. government will help avoid future problems in U.S. financial institutions.

(c) Investment Committee Report

The Chairman reviewed the minutes of the October 6, 2008 Investment Committee meeting in Dr. Peck's absence. The Chairman indicated that Mercer presented an educational presentation on infrastructure investments, which detailed what these investments consist of and the associated risks. The Chairman also reported that the Investment Committee had a discussion with Mercer on the current state of the financial markets. Ms. Mayr asked a question regarding whether investment managers are responding to Mercer with information in a timely manner. Mr. Silvestri indicated that the Investment Committee meetings are held during the first week of the month and it is hard to receive month end performance data that quickly. The Chairman noted that the turmoil in the market may be causing some delays in the processing of information.

7. Virchow Krause Audit Overview

Mr. Morgan and Ms. Middleman from Virchow, Krause & Co. LLP distributed and presented a required communication to the Board under FAS 114, the audit opinion letter contained in the annual report and a management comment letter required under SAS 112. Mr. Morgan stated that the FAS 114 letter indicates that there were no significant or unusual items noted during the 2007 audit of ERS. He noted that his firm did not audit the actuarial funded status of the plans, but reviewed the actuarial variables for reasonableness and conducted a sensitivity analysis. He indicated that his firm is independent of ERS and OBRA.

The Chairman inquired about the random review of retirees' files. Mr. Mueller stated that he thinks the auditors did a substantial and thorough job reviewing the files. Mr. Morgan discussed the statistical and nonstatistical review of the retirees' files.

Mr. Morgan reviewed his firm's opinion letter contained in the annual report, paragraph by paragraph. He stated that his firm opined that the financial statements are free from

material misstatement. He described the items his firm audited. He pointed out that some items are not audited, for example ERS's ten-year trend and other supplemental schedules. He noted that Retirement Office management represented that nothing is out of the ordinary and the financial information undergoes regular and thorough analysis throughout the year.

Mr. Morgan reviewed the management comment letter, which is required under SAS 112. He stated that there are required disclosures which focus on internal control deficiencies and there are also voluntary disclosures in which the auditors make procedural recommendations. He discussed the difference between a significant and an insignificant control deficiency and their impacts on the financial statements. He reported that the audit team discovered one lowest level control deficiency during the audit. He noted that the control deficiency occurred when interest income was misclassified, but it did not affect the financial statements. He recommended that all financial statement entries be reviewed for correctness by a party other than the one who made the entry. The Chairman stated that this internal control situation will be referred to the Audit Committee. He noted that the Audit Committee needs additional members because of Mr. Parish's retirement.

Mr. Morgan reported on other areas where his firm made voluntary recommendations for improvement. He noted that there should be better formal documentation of the decision-making processes. He indicated that Retirement Office management responded with a letter addressing the audit team's concerns. In response to a question from Ms. Mayr, it was noted that Mr. Arena responded to the auditors on behalf of Retirement Office management. Ms. Mayr pointed out that the letter is in draft form and dated August 5, 2008. Mr. Morgan indicated that the management comment letter is part of a larger County audit.

Mr. Morgan suggested having a formal meeting or electronic exchanges with the Audit Committee to discuss the recommendations contained in the management letter. In response to a question from Mr. Grady, Mr. Morgan stated that the audit team could probably review the management letter with the Pension Board or Audit Committee each September before Retirement Office management responds to the management letter.

Mr. Morgan commented that the Retirement Office currently has the same person prepare and review the financial statements. He suggested that the best practice is for separate positions to prepare and review the financial statements. He noted that Retirement Office management agreed with the voluntary recommendations and has taken steps to create separate positions. He indicated that his firm had trouble locating some of the files for testing, but stated that the impact on the financial statements was insignificant.

8. Vitech Project Report

Mr. Arena reported that significant progress has been made with the Vitech project. He thanked the individuals who are working on the project for their efforts. Mr. Pillai indicated that the project is in the home stretch. He stated that the pension aspect of the project is 95% complete. He noted that Vitech is running its second level of testing, which is systems regression testing. He pointed out that the County plans to begin user acceptance testing in late November. He reported that the life and health module is slightly behind the pension module and he anticipates user acceptance testing to begin on the life and health module during the first week of December. He noted that testing for the life and health module is easier than the testing performed on the pension module.

Mr. Felber indicated that United Healthcare is a new vendor for health insurance for the County, but that the Deputy Sheriffs utilize WPS. He noted that the Deputy Sheriff's could use other vendors in the future. Ms. Mayr stated that she believes that the health care vendor applicable to the CBA applies to the labor unit's retirees. Mr. Pillai explained that the testing is being performed on both systems and he will check and confirm that other vendors can be accurately processed by the system. Mr. Arena discussed how the out-of-state network for United Healthcare is much more comprehensive than WPS's subcontracted out-of-state network. He noted that there should be few or no network-related issues.

Ms. Mayr stated that DC48 has refunds coming from various health providers. Mr. Grady indicated that this is a topic in litigation, does not relate to Vitech and is off the agenda. Mr. Arena stated that he will clarify these issues with Ms. Mayr at a later time.

In response to a question from the Chairman, Mr. Pillai indicated that the system interfaces are being tested. Mr. Pillai stated that one module of ERS training has been completed and the pension training will be completed next week. Mr. Arena noted that all of the responses to the system during training have been very positive.

Mr. Pillai pointed out that the project's budget has not changed since last month. He reviewed the project's risk management quadrant and commented that this is the most important item. He pointed out that testing and the life and health module implementation are the two primary areas of concern. He noted that he wants the pension and life and health module to go live at the same time. Mr. Grady stated that the Pension Board is not responsible for retiree medical benefits and should only be concerned if that module affects ERS.

9. Vitech Implementation Oversight Committee Report.

Mr. Parish stated that at its last meeting, the Vitech Implementation Oversight Committee discussed the systems testing, which began on October 1, 2008.

10. Audit Committee Report

Mr. Parish stated that the September 25, 2008 Audit Committee meeting was canceled. He described the creation of the evaluation panel for the purpose of evaluating the responses to the investment consulting RFP and reviewed the progress that has been made in the evaluation process.

11. Administrative Matters

The Chairman asked if any Board member has anything to add to the future topics list. In response to a question from Ms. Mayr, the Chairman stated that the Board would welcome input from the retirees on a speaker for the presentation on the economy at the annual meeting. The Chairman indicated that it is normally an ERS investment manager or consultant who speaks at the meeting.

Mr. Cohen reported that the mayor is creating a task force on foreclosure prevention. Mr. Cohen indicated that there may be a place for ERS to participate if there is little risk. The Chairman indicated that ERS would need to be highly securitized to consider participating in such a program.

12. Disability Pensions

(a) Earned Income Statements – Rule 1010

The Chairman indicated that Shelton Smith and Robert D. Allen did not submit their earned income statements as required under Rule 1010 and have not responded to repeated requests for this information. Mr. Grady inquired whether the Board is considering suspending benefits and the Chairman responded that the Board was considering suspending the benefit payments. In response to Mr. Felber's question, Mr. Arena said that the Retirement Office has not received the required items after two to three attempts per individual. Mr. Arena noted that the Retirement Office has been using correct addresses.

The Pension Board voted 6-1, with Mr. Felber dissenting, to suspend the benefit payments of Shelton Smith and Robert D. Allen until they comply with the requirements under Rule 1010. Motion by Ms. Bedford, seconded by Ms. Mayr.

(b) Disability Applications

(i) Michael Elm – ADR.

The Pension Board unanimously approved Mr. Elm's accidental disability application based upon the recommendation of the Medical Board. Motion by Mr. Cohen, seconded by Mr. Parish.

- (ii) Jean DeStefanis – ADR.

The Pension Board unanimously approved Ms. DeStefanis' accidental disability application based upon the recommendation of the Medical Board. Motion by Mr. Felber, seconded by Mr. Cohen.

- (iii) Warzella Bowie – ODR.

The Pension Board unanimously approved Ms. Bowie's ordinary disability application based upon the recommendation of the Medical Board. Motion by Mr. Felber, seconded by Mr. Parish.

- (iv) Tim Johnson – ADR.

The Pension Board unanimously approved Mr. Johnson's accidental disability application based upon the recommendation of the Medical Board. Motion by Mr. Felber, seconded by Ms. Mayr.

- (v) Jeffrey Yourich – ADR.

The Pension Board unanimously approved Mr. Yourich's accidental disability application based upon the recommendation of the Medical Board. Motion by Mr. Felber, seconded by Mr. Parish.

- (c) Lori Jemison – Application of Earned Income Limitation.

Mr. Grady reported that Ms. Jemison's attorney cannot attend the meeting and her attorney stated that the Pension Board can rely on the written materials contained in the meeting packet when rendering its decision.

Ms. Bedford moved that the Pension Board adjourn into closed session for the purpose of receiving oral or written advice from legal counsel concerning strategy to be adopted with respect to pending or possible litigation and for considering the financial, medical, social or personal histories or disciplinary data of specific persons which, if discussed in public, would be likely to have a substantial adverse effect upon the reputation of any person referred to in such histories or data.

The Pension Board voted 6-0 by roll call to enter into closed session to discuss Agenda Items 12(c), 13, 15 and 16.

13. Pending Litigation

The Board discussed the following pending litigation in closed session:

Milwaukee County, et al. v. Mercer Human Resource Consulting.

14. Report on Special Investigation

In open session, Ms. Riley noted that there is nothing new to report regarding the special investigation.

15. Report on Compliance Review

The Board discussed the report on compliance review in closed session.

16. ERS and OBRA Ordinance Amendments

In open session, Mr. Huff reported that government plan sponsors should submit their plans to the IRS for determination letters by January 31, 2009. He indicated that amendments have been prepared to the ERS and OBRA Ordinances and the Pension Board should approve these amendments before they go to the County Board along with the actuarial cost study. He discussed how some of the amendments were previously presented to the Pension Board. He noted that a majority of the amendments are mandatory to comply with the Internal Revenue Code, while some are suggested to ease the administration of the plans. He reviewed each of the proposed amendments in detail.

Upon returning to open session, the Pension Board unanimously agreed to obtain an actuarial cost study on the proposed amendments to the ERS and OBRA Ordinances. Motion by Ms. Mayr, seconded by Ms. Bedford.

17. Adjournment

The meeting adjourned at 1:45 p.m.

Submitted by Steven D. Huff,
Secretary of the Pension Board